

522 : PMSE / FIFC as to Seller

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Statesboro Division

In the matter of:

THOMAS FREDERICK HENDERSON
f/d/b/a Commercial Painting
VERA M. HENDERSON
f/k/a Vera M. Lanier

Debtors

THOMAS FREDERICK HENDERSON
VERA M. HENDERSON

Movants

v.

FARMERS FURNITURE
and
SECURITY FINANCE

Respondents

Chapter 7 Case

Number 687-00169

FILED

at 11 O'clock & 30 min. AM

Date 5/2/88

MARY C. BECTON, CLERK
United States Bankruptcy Court
Savannah, Georgia *PCB*

MEMORANDUM AND ORDER
ON MOTION TO AVOID LIENS ON EXEMPT PROPERTY

Farmers Furniture claims a security interest in certain household goods and furnishings of the Debtors. Debtors seek to avoid that security interest pursuant to 11 U.S.C. Section 522(f)(2). After consideration of the evidence adduced at the hearing I make the following Findings of Fact and

Conclusions of Law.

FINDINGS OF FACT

1) The parties stipulate that they entered into five retail installment contracts/security agreement transactions.

2) The five transactions are as follows:

<u>CONTRACT NUMBER</u>	<u>DATE</u>	<u>DESCRIPTION</u>	<u>CASH PRICE</u>	<u>UNPAID BALANCE/ AMOUNT FINANCED</u>
237000	5-7-85	Tables, Benches, Chairs	\$415.95	\$396.19
246839	5-27-85	Television	\$883.95	\$1,345.97
264453	9-19-85	Sofa, Chair, Love Seat	\$831.95	\$2,131.52
034528	3-28-86	Magnavox	\$260.00	\$2,077.74
44353	11-27-86	Dryer	\$467.90	\$2,063.50

The unpaid balance includes the unpaid balance of the cash price of the item(s) in each particular contract plus the balance owed on the prior contract(s) less refunds of unearned finance charges and unearned insurance premiums on prior contracts. In all five transactions the buyer granted to the seller a purchase money

security interest in all merchandise purchased under the contract. In addition, all five contracts include a consolidation clause which retains for the seller an ongoing security interest in all the merchandise purchased until the debt is paid in full. Each contract entered into subsequent to the first contract gives a security interest in all prior contracts which specifically references them by their appropriate contract numbers. Only the fifth contract contains a "first in first out" clause which indicates the order in which purchases are to be paid off.

CONCLUSIONS OF LAW

The initial issue which confronts this Court is whether the consolidation by a retail seller of unpaid balances due on prior contracts with the balance due under a new contract destroys the purchase money security interest which the retail seller asserts. A determination of this issue is resolved by turning to state law. In re Manuel, 507 F.2d 990 (5th Cir. 1975). Under Georgia law: "A security interest is a 'purchase money security interest' to the extent that it is: (a) Taken or retained by the seller of a collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if its value is in

fact so used." O.C.G.A. §11-9-107. The two controlling cases in this circuit are In re Manuel, supra, and South Trust Bank of Alabama, National Assoc. v. Borg-Warner Acceptance Corp., 760 F.2d 1240 (11th Cir. 1985). The Manuel decision dealt with a seller, as contemplated in O.C.G.A. 11-9-107(a), who took a purchase money security interest in certain household furniture and subsequently took a purchase money security interest in a television set through a purchase money agreement which consolidated the balance owing on the household furniture with that owing on the television set. By so doing, the creditor sought to consolidate the debt and preserve its purchase money security interest in all the collateral. Borg-Warner Acceptance Corporation, on the other hand, dealt with a purchase money lender as contemplated by O.C.G.A. §11-9-107(b) (See UCC Official Comment No.2) who purchased invoices from lenders and supplied inventory items pursuant to the terms of security agreements which contained an after acquired property clause. In the instant case, Farmers Furniture is a retail seller¹ who like the

¹ O.C.G.A. §10-1-2(a)(11) of the Georgia Retail Installment and Home Solicitation Sales Act provides that "'Retail seller' or 'seller' is a person regularly engaged in, and whose business consists to a substantial extent of, selling goods or services to a retail buyer. The term also includes a seller who regularly grants credit to retail buyers for the purpose of purchasing goods or services from any other person pursuant to a retail installment contract or a revolving charge account."

seller in Manuel took a purchase money security interest in certain household goods, financed the purchase of additional household goods at a later time, and sought to retain its purchase money security interest in the original and additional goods by consolidating the unpaid balance of prior contract with the amount financed in later contracts. In light of the factual similarities between Manuel and the instant case, Manuel, not Borg-Warner, is controlling of the initial issue raised herein.

The court in Manuel held:

"A plain reading of the statutory requirements would indicate that they required a purchase money security interest to be in the item purchased, and that, as the judges below noted, the purchase money security interest cannot exceed the price of what is purchased in the transaction wherein the security interest is created, if the vendor is to be protected despite the absence of filing." Id at 993.

The effect of the Manuel holding is to transform a purchase money security interest into a non-purchase money security interest where creditors attempt to hold collateral to secure debt in excess of its own price by consolidating the unpaid balance of prior contracts with the price of the new item financed. The Manuel court limited its holding to the goods purchased under the prior contract because the issue of whether the creditor had a valid purchase money security interest in the current purchase

was not preserved by cross-appeal:

"We express no view as to whether a valid purchase money security interest was created with respect to the t.v. set. Nothing we say is to be taken as a holding as to that." Id. at 994.

In the instant case, it is clear that the unpaid balances due under the first four contracts were consolidated with the new item financed in a fifth contract. In applying the rule set forth in Manuel it initially appears that the purchase money security interest asserted in the first four contracts is destroyed because the purchase money security interest of some \$2,063.58 exceeds the \$467.90 price of the dryer purchased under the fifth contract. Upon a closer analysis of the dicta contained in Manuel, the Georgia case law and the statutory language, however, a different result is warranted in regards to the fifth contract.

Throughout the Manuel opinion, it is suggested that it was the creditor's failure to carry its burden of proof to establish security interest and the extent to which it was taken or retained which proved fatal. Id. at 993. In several places, moreover, the court focused on the fact that while the security agreement shows the amount paid and the total debt remaining, it presents "no clues as to what items are paid for

and which are not, nor does any rule of first-bought, first-paid for appear." Id. (Also see the court's recitation of the facts which in part states that "the agreement also failed to indicate the order in which purchases were paid off, and the amount still due on each item and secured by the paid-up items" Id. at 991.) This suggests that a first in first out clause in the security agreement might have saved the creditor's purchase money security interest. In this circuit, further support for this proposition can be found in Borg-Warner, wherein the court states that:

"Unless a lender contractually provides some method for determining the extent to which each item of collateral secures its purchase money, it effectively gives up its purchase money status." supra at 1243.

It must be emphasized, however, that neither the old Fifth Circuit in Manuel nor the present Eleventh Circuit in Borg-Warner has dispositively ruled on the effect of a first in first out clause in a security agreement on a purchase money security interest claimed by a seller who has consolidated unpaid balances due from prior security agreements with a total purchase price of a subsequent agreement.

The issue of whether a first in first out clause in a security agreement operates to preserve a seller's existing purchase money security interest has been addressed in In re

McCall, 62 B.R. 57 (M.D.Ala. 1985).² The McCall court concluded after a thorough analysis of the policies underlying the creation of purchase money security interests that a express contractual first in first out clause allows the seller's purchase money security interest to survive. Further support is found for the McCall rule in the express language of O.C.G.A. §11-9-107 which provides in relevant part:

"A security interest is a 'purchase money security interest' to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price . . . "

Stated differently, a "seller" has a purchase money security interest to the extent that he takes or retains a security interest to secure all or part of its price. Clearly, the statutory language contemplates that the seller can retain, as he did in the instant case, a purchase money security interest to the extent the contract so provides, but not in excess of the purchase price.

² The McCall court decided the issue under Alabama Code Section 7-9-107 which is identical to O.C.G.A. §11-9-107.

It is equally clear, however, that the seller cannot claim a purchase money security interest in the collateral to the extent that it has been released from the security agreement by the application of monthly payments. McCall, supra, at 59.³ Accordingly, I hold that an express first in first out clause in a security agreement which consolidates the unpaid balance of one prior contract operates to prevent the destruction of an otherwise valid purchase money security interest. Furthermore, a seller who retains a purchase money security interest taken in a prior contract can continue to claim a

³ Two other courts in this Circuit have considered whether the inclusion of an express first in first out clause in the security agreement saves a purchase money security interest from the "transformation rule" of Manuel and Borg-Warner. These cases are In re Staley, 426 F.Supp. 437 (M.D.Ga. 1977) and Matter of Franklin, 75 B.R. 268 (Bankr.M.D.Ga. 1986). The issue which confronted these courts was whether the inclusion of an express first in first out clause in the security agreement between a person who is not a seller and the debtor operates to save a purchase money security interest from the "transformation rule". The case sub judicio does not involve a person "who is not a seller" which is governed by O.C.G.A. §11-9-107(b) (See U.C.C. Official Comment 2), but rather involves a "seller" and is governed by O.C.G.A. §11-9-107(a). As such, these cases are readily distinguishable. Moreover, in light of the language contained in U.C.C. Official Comment Number 2, a strong argument could be made that §11-9-107(b) is to be construed more narrowly than §11-9-107(a). In effect, an entirely different rule could be adopted than the rule adopted herein, with respect to a person "who is not a seller".

purchase money security interest in the collateral, but only to the extent that it has not been released by application of the debtor's monthly payments.

An application of the rule adopted herein to the instant case is reasonably straight forward. The first four contracts contain a consolidation clause and retain the security interest taken in prior contracts. The first four contracts, however, do not contain a first in first out clause which would prevent the destruction of the purchase money security interest claimed and retained therein. Therefore, the purchase money security interest claimed by the seller in the first four contracts are destroyed by operation of the "transformation rule". The first in first out clause in the fifth contract does not operate to restore and elevate the destroyed purchase money security interests claimed in the first four contracts. The first in first out rule operates prospectively not retroactively. The effect of the first in first out clause contained in the fifth contract is to prevent the destruction of the purchase money security interest in the dryer, but all other purchase money security interests contained in prior contracts are lost to the transformation rule.

O R D E R

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the Motion to Avoid Liens is granted as to all items except the dryer listed on Contract Number 44353.



Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 29th day of April, 1988.